Can Reengineering the Pay Cycle Disrupt Payday Lending?

By Mary Wisniewski
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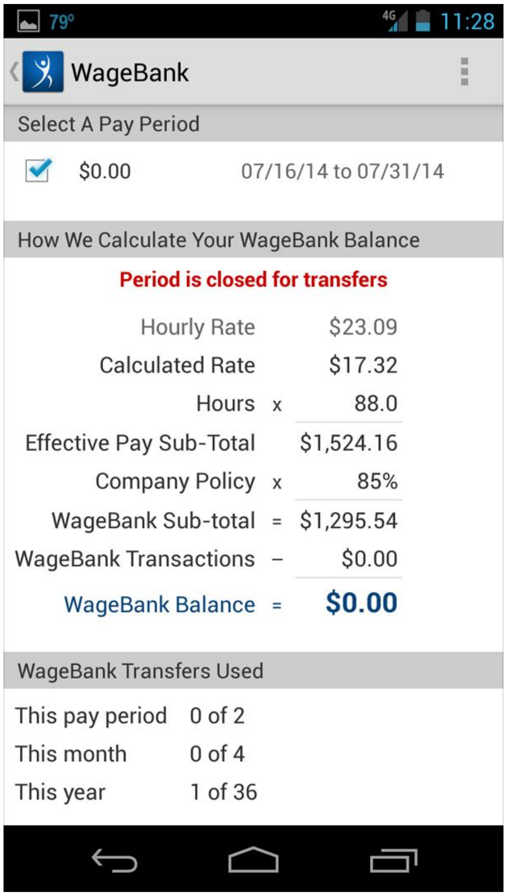

FlexWage's WageBank mobile app

A couple of young companies are marketing a new employee benefit that serves the same purpose as a payday loan but costs the consumer less.

In so doing, they are shaking up the traditional pay cycle: People can address immediate funding needs by accessing portions of their paychecks they have already earned up to that point, regardless of the day of the week. Unlike a payday loan, the amount advanced is tied closely to wages owed.

The need for ways to solve consumers' short-term liquidity problems is widely recognized. But a public debate rages over how to address that need. In recent months, several banks have dropped

out of the deposit advance loan business following regulatory pressure. And the long-controversial payday lending industry faces heightened government scrutiny.

In the last four weeks, two payroll-related disruptors have closed small financing rounds. Both offer products designed to tide over cash-flow-challenged consumers who need to pay for, say, a flat tire or a new renter's insurance policy.

"People run into cash flow issues all of the time," said Frank Dombroski, founder and chief executive of FlexWage, one of the upstarts, and a former executive at JPMorgan Chase. "There's a huge demand for this kind of product."

His Mountainside, N.J., company, which formed in 2009 to provide alternatives to high-cost lenders, announced in early August it had raised $3.5 million to fund an expansion. With the financing, it will work to forge partnerships with financial institutions and to sign larger employers or potentially a large bank. To date, it works with 150 employers, whose workers most often request $220.

FlexWage is not a lender; rather, it crunches data on employees' pay rates and hours worked, which it collects by interfacing with employers' payroll and time systems. Then, it accesses the payroll accrual funds to provide people with the early disbursement money.

"At the end of the day, we are launching a new benefit," said Dombroski. "It's not difficult but it's a project."

The offering, called WageBank, integrates with a mobile app and works in conjunction with a payroll card.

FlexWage is one of a number of young companies reimagining short-term credit, including the way to profit from such products. FlexWage charges employers a "small per-active-user fee" in addition to a $3 to $5 flat rate for the employees, Dombroski said.

Activehours, a rival that introduced a slick-looking app in May, closed $4.1 million in seed financing in late July. Instead of partnering with employers, the Palo Alto, Calif., company courts consumers directly. Hourly wage earners — ranging from Uber and Lyft drivers to bank employees — request portions of their paycheck, which they will receive the next day. Come payday, Activehours will automatically withdraw the funds owed.

"If you've already put in the hours at work and earned your pay, you should be able to access it and use it when you want," said Ram Palaniappan, a founder of Activehours, in a press release announcing the financing.

There are already payroll loan companies that tie their offerings to the borrower's employer and acredit union think tank is working to broaden a small-dollar loan product that automatically deducts loan payments from direct-deposited paychecks.

In a novel twist, instead of charging consumers a fee, Activehours asks users for tips, like a waiter or washroom attendant, essentially letting customers name their price.

Whether that revenue model is viable over the long term, or a loss leader for an eventual broader offering, remains to be seen. Activehours did not respond to requests for comment.

To be clear, there are restrictions. One must receive direct deposits into a bank account, get paid an hourly rate, live in the U.S. and fill out computerized or online timesheets at work.

Activehours bashes banks in its marketing: "We don't like the way banks exploit customers. We want to have a different type of relationship — one based on mutual trust, support, and lots of good karma."

Whether products like those from FlexWage and Activehours are the right solution to a clear need may depend on who is using it.

"It's not a monolithic one-size-fits-all marketplace," said Jeanne Hogarth, vice president of policy at the Center for Financial Services Innovation.

Sure, there are emergency expenses and misaligned cash flow issues such as a parent needing to cough up for summer camp during the winter. But there are individuals who always spend more than they make. For those consumers, "credit will never be an answer," said Hogarth.

There could be other options for people with cash flow problems. A consumer could contact a biller to try to negotiate a different due date better aligned with the pay cycle, she suggested.

Other companies, including banks, have been creating digital tools to help people become more aware of their discretionary spending habits to avoid low-on-funds scenarios. PNC Bank, KeyBank and Wells Fargo have all made available apps that let customers forecast their checking account balances, for example.

FlexWage allows its employer partners to set the parameters on how many times their employees can dip into accrued pay, to prevent them from abusing the service.

The company hopes to demonstrate to employers that a benefit like WageBank will help them retain hourly paid workers.

"Employers need to know there is a payoff for them," said Dombroski.

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Monthly bills but biweekly paychecks. Does anyone else see the problems this causes? It doesn't matter if consumers can change monthly due dates if they get paid biweekly since the paychecks come at different times of the month. I like the idea of the new products to help solve this issue. Not sure why they try to bash banks when it is employers and payroll processors that decide when you get paid.

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